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CITATIONS

511411—43

In the Supreme Court of the United States

OCTOBER TERM, 1942

No. 660

MOLINE PROPERTIES, INC., PETITIONER

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the Board of Tax Appeals (R. 16–22) is reported in 45 B. T. A. 647. The opinion of the Circuit Court of Appeals (R. 89–91) is unreported.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered November 7, 1942 (R. 91). Petition for rehearing was denied December 11, 1942 (R. 98). The petition for a writ of certiorari was filed on January 18, 1943. Jurisdiction is conferred on

this Court under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether the profits realized by petitioner corporation should be included in its taxable gross income or whether, as petitioner contends, the corporate entity should be disregarded and its income attributed to its sole stockholder.

STATUTES INVOLVED

Revenue Act of 1934, c. 277, 48 Stat. 680:

> SEC. 13. TAX ON CORPORATIONS.
>
> (a) *Rate of tax.*—There shall be levied, collected, and paid for each taxable year upon the net income of every corporation, * * *
>
> SEC. 22. GROSS INCOME.
>
> (a) *General definition.*—"Gross income" includes gains, profits, and income derived from * * * sales, * * *
>
> SEC. 52. CORPORATION RETURNS.
>
> Every corporation subject to taxation under this title shall make a return, * * *

Revenue Act of 1936, c. 690, 49 Stat. 1648:

> SEC. 13. NORMAL TAX ON CORPORATIONS.
>
> * * * * *
>
> (b) *Imposition of tax.*—There shall be levied, collected, and paid for each taxable year upon the normal-tax net income of every corporation, a normal tax as follows:
>
> * * * * *

The provisions of Sections 22 (a) and 52 of the Revenue Act of 1936, *supra*, are identical with those set forth above.

STATEMENT

This case involves petitioner's income tax liability for the years 1935 and 1936. The facts as found by the Board of Tax Appeals (R. 17–19) may be summarized as follows:

The petitioner is a corporation, organized under the laws of Florida in 1928. Its president and sole stockholder, with the exception of holders of qualifying shares, has at all times been Uly O. Thompson. (R. 17.)

On August 17, 1920, Thompson acquired certain real estate in Florida, which he mortgaged in 1923 for $20,000. On March 18, 1926, he gave a second mortgage on this property to Miami Beach Bank and Trust Company, hereinafter referred to as Miami, to secure an additional loan of $20,000. (R. 17.)

Subsequently, Thompson failed to pay the taxes on the property and was told by the second mortgagee that the taxes would have to be paid to prevent the loss of the property. The proposal was made that the Bank of Bay Biscayne, hereinafter referred to as Biscayne, with which Miami was affiliated, would lend $6,750 to pay the accumulated taxes if Thompson would authorize Biscayne to organize a corporation to hold title to the property which was identified as "Block 77." (R. 17,

36.) The stock of the corporation would be issued to Thompson. It would then be pledged as collateral for the loan and placed by Thompson in a voting trust to be controlled by the bank. The trust would cease either on payment of the loan or sale of the pledged stock. (R. 17.) Pursuant to this agreement the petitioner was organized and its stock, with the exception of qualifying shares, issued to Thompson. On June 5, 1928, Thompson conveyed Block 77 to the petitioner and executed the voting trust agreement. The petitioner assumed and agreed to pay the two mortgages as a part of the purchase price. (R. 17–18.)

Biscayne closed in 1930 and its powers under the voting trust were thereafter exercised by the bank liquidator (R. 18). The debt of $6,750 owed to Biscayne was settled by the petitioner during 1933 (R. 18). In that year the stock of the petitioner which had been pledged and held under the voting trust was returned to Thompson (R. 18). On July 29, 1933, the petitioner discharged and satisfied the two mortgages which were outstanding on the property owned by it, each in the amount of $20,000. Funds for these discharges were obtained by Thompson through a loan which he negotiated with the National Investment Holdings, Inc. This loan was secured by a mortgage on a portion of the property in question. (R. 18.)

Sometime during the period that the voting trust was in effect a suit was instituted to remove cer-

tain restrictions imposed on Block 77 by a prior deed. Of the expenses connected with this suit, $4,005.39 was paid by Thompson in 1933 and subsequent years. The petitioner was also required to defend a certain condemnation proceeding during this period. (R. 18.)

The petitioner on October 1, 1929, purchased from Biscayne a note of Thompson's, together with a real-estate mortgage securing it, in the amount of $43,000, on which interest of $9,703.14 was due, at its par value plus accrued interest. The petitioner gave its note for the purchase price, securing it with Thompson's mortgage, which it received on the purchase of the note. (R. 18.)

The petitioner's property was sold in three separate parcels, one in each of the years 1934, 1935, and 1936 (R. 19). The debt owed to National was paid in 1936 from the proceeds of the sales (R. 18). The proceeds of the sales were received by Thompson, who deposited them in his bank account (R. 19).

The sales made in 1934 and 1935 were reported in the income tax returns of the petitioner. A loss was reported for 1934 and a gain for 1935. Subsequently Thompson was advised by his auditor that due to the circumstances of the petitioner's organization, these sales might be reported by Thompson and a claim for refund of tax accordingly filed on the petitioner's behalf for 1935. In a delinquent

return filed in 1938, Thompson reported the 1935 gain as his individual gain. Gain on the 1936 sale was reported by Thompson. (R. 19.)

The petitioner did not keep books of account or maintain a bank account. It owned no assets other than the real estate described above. It leased a portion of its properties in 1934 for parking lot purposes, from which it received rental of $1,000. Thompson owned other real property in Miami, title to which was in his name individually. (R. 19.)

During 1934 and a part of 1935 Thompson was a circuit judge of the State of Florida. His salary was his principal source of income. When his office was abolished in 1935 he returned to the practice of law. (R. 19.)

The petitioner has not been dissolved. However, it has transacted no business since the sale of its property in 1936. (R. 19.)

The Commissioner ruled that the profits realized by petitioner in 1935 and 1936 must be included in its taxable income, but the Board of Tax Appeals reversed, holding that the existence of the taxpayer must be disregarded for tax purposes (R. 19–22). The Circuit Court of Appeals in turn reversed the Board and held that Thompson having voluntarily chosen to organize petitioner to conduct certain business affairs, both he and petitioner could not disavow the corporate entity in order to obtain a tax advantage thereby (R. 91).

ARGUMENT

The court below held that petitioner could not disavow its own existence in order to avoid a tax disadvantage resulting from its creation. The decision is correct; it presents no conflict.

The rule is well established that a corporation and its stockholders are ordinarily separate entities for tax as well as other purposes. *Klein* v. *Board of Supervisors*, 282 U. S. 19; *Dalton* v. *Bowers*, 287 U. S. 404; *Burnet* v. *Clark*, 287 U. S. 410; *Burnet* v. *Commonwealth Imp. Co.*, 287 U. S. 415; *New Colonial Co.* v. *Helvering*, 292 U. S. 435. In *Higgins* v. *Smith*, 308 U. S. 473, this Court, in the course of holding that a taxpayer who had organized a corporation wholly owned by him was entitled to no loss deduction upon the sale of securities to such corporation, nevertheless declared (p. 477):

> A taxpayer is free to adopt such organization for his affairs as he may choose and having elected to do some business as a corporation, he must accept the tax disadvantages.

This principle has been widely applied. See, *e. g.*, *Esmond Mills* v. *Commissioner* (C. C. A. 1st), decided January 7, 1943 (1943 C. C. H., par. 9237); *Palcar Real Estate Co.* v. *Commissioner*, 131 F. 2d 210 (C. C. A. 8th); *Interstate Transit Lines* v. *Commissioner*, 130 F. 2d 136 (C. C. A. 8th), pending on petition for certiorari, No. 552, present Term; *Vim Securities Corp.* v. *Commissioner*, 130 F. 2d 106

(C. C. A. 2d), certiorari denied December 7, 1942, No. 508, present Term; *Texas-Empire Pipe Line Co.* v. *Commissioner*, 127 F. 2d 220 (C. C. A. 10th); *Salmon* v. *Commissioner*, 126 F. 2d 203 (C. C. A. 2d); *Watson* v. *Commissioner*, 124 F. 2d 437 (C. C. A. 2d).

The court below decided that this principle was properly applicable to the instant case. If, as the Board of Tax Appeals said, petitioner was created (R. 20)—

> as a means of protecting their [the creditors'] investments and of saving his [Thompson's] equity in certain Florida real estate,

it is clear that it was created to carry out a business purpose.[1] To say that petitioner may disavow its corporate existence on the ground that it was merely a "dummy" corporation serving no business purpose would be to negate the very reason for which it was brought into being.

When petitioner was first organized, Thompson had no control over it (cf. *New Colonial Co.* v. *Helvering*, *supra*, p. 441), and even after the voting trust agreement was terminated in 1933 he was simply in the position of a person taking over the stock of a corporation already organized and functioning. After the settlement of the $6,750 loan from Biscayne and the payment of the two mort-

[1] The petitioner's charter authorized it to carry on broad and varied activities (R. 61–70).

gages, petitioner continued its corporate existence. In 1934 it received income from renting a portion of its property and it was engaged in litigation with respect to a deed restriction and in selling its property at least through part of 1936. Some of the proceeds from the sale of property in 1936 were used to pay the loan authorized by petitioner and secured by a mortgage on its property, as well as accumulated taxes against the property.

The court below did not hold, as petitioner assumes, that in every instance a taxpayer who forms a corporation is precluded from showing the true nature of the arrangement so as to escape a tax disadvantage. Rather, it held that in the circumstances here involved, where petitioner was organized to conduct certain business affairs, and did conduct them, the corporate existence could not be ignored in an effort to secure thereby a tax advantage.

The present case is not, as petitioner asserts, in conflict with either *United States* v. *Brager Building & Land Corp.*, 124 F. 2d 349 (C. C. A. 4th), or *Inland Development Co.* v. *Commissioner*, 120 F. 2d 986 (C. C. A. 10th).[2] It is true that in each of these cases the taxpayer prevailed in his contention that the separate identity of the cor-

[2] *North Jersey Title Ins. Co.* v. *Commissioner*, 84 F. 2d 898 (C. C. A. 3d), which petitioner also contends is in conflict with the court's decision in the present case, was decided prior to *Higgins* v. *Smith*. It involved a situation similar to that presented in the *Brager* case.

porations involved should be disregarded. But obviously it cannot be said that a conflict exists simply because in some cases the corporate entity is disregarded, while in others it is not. The *Brager* case (pp. 350, 352) turned on the circumstance that the corporation was of a "purely nominal character," which "had no business activities and served no purpose other than the passive holding of the legal title" to property. The Circuit Court of Appeals for the Fourth Circuit itself has subsequently distinguished the *Brager* case on this ground. See *American Package Corp.* v. *Commissioner*, 125 F. 2d 413, 415 (C. C. A. 4th).[1]

In *Inland Development Co.* v. *Commissioner*, which involved the application of the personal holding company statute, the Circuit Court of Appeals for the Tenth Circuit disregarded the corporate identity of the several subsidiary companies on the ground (p. 989) that such subsidiaries were nothing more than "voiceless departments" or mere agents of the parent taxpayer. The situation

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[1] It is questionable whether the same result would have been reached by the Fourth Circuit in the *Brager* case if that case had been decided after the reversal of its decision in *Powell* v. *Gray*, 114 F. 2d 752 (C. C. A. 4th), in which this Court, citing *Higgins* v. *Smith*, *supra*, stated (314 U. S. 402, 414): "The choice of disregarding a deliberately chosen arrangement for conducting business affairs does not lie with the creator of the plan."

It is also not without significance that unlike the petitioner here, the corporation in the *Brager* case did not assume the mortgage debt against the property transferred to it.

in that case was deemed distinguishable by the same court in the later case of *Texas-Empire Pipe Line Co.* v. *Commissioner, supra*, p. 224, where the Tenth Circuit found that the subsidiaries there involved were created to serve a "legitimate business purpose." Both the *Brager* and *Inland Development Company* cases presented "peculiar situations and were determined upon consideration of them."[4] *Interstate Transit Lines* v. *Commissioner, supra*, p. 140. See also *Palcar Real Estate Co.* v. *Commissioner, supra.*

Irrespective of whether the facts of those cases might have justified the conclusion that the corporations in question were "substantial" enough so as not to be disregarded, the instant case presents a situation where petitioner clearly was created a business purpose and was employed to carry out that objective. As such it cannot contend that its existence was "illusory." Cf. *Vim Securities Corp.* v. *Commissioner, supra*, p. 109.

The present case does not raise the question, and this Court should not, as petitioner insists, be called upon to decide "whether *under any circumstances* a taxpayer may invoke the 'agency' doc-

[4] Even before *Higgins* v. *Smith*, the anomalous cases in which corporate entities were disregarded at the insistence of the taxpayer were carefully limited to the exceptional situations and peculiar facts which they presented. See *Southern Pacific Co.* v. *Lowe*, 247 U. S. 330, 338. Cf. *Burnet* v. *Commonwealth Imp. Co., supra*, pp. 419–420; *New Colonial Co.* v. *Helvering, supra*, p. 442.

trine, or is wholly estopped from doing so *by the mere circumstance, without more,* that he has brought the entity into its fictional being" (Pet. 10). [Italics supplied.]

CONCLUSION

The decision below is correct. There is no conflict of decisions. The petition should be denied.

Respectfully submitted.

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